



AUSTRALIAN INDUSTRY  
GROUP

**Australian Industry Group Submission**

**Australia in the Asian Century**

**March 2012**

## Foreword

The Australian Industry Group welcomes the opportunity to provide a submission to the White Paper on Australia in the Asian Century, which offers a review of economic and strategic change in Asia and the opportunities for Australia. The White Paper is relevant and timely for the business community, and the Australian Government should be applauded for commissioning this work.

This submission prepared by the Australian Industry Group, presents our analysis of the emerging economic and social trends in Asia, as well as the challenges and opportunities facing to Australian businesses.

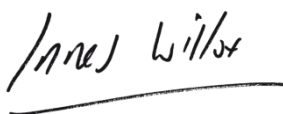
The resilience of the Asian economy is demonstrated by the strong economic growth it achieved in the past two years in spite of the ongoing fallout from the global financial crisis. Healthier banking systems since the Asian financial crisis, strong macroeconomic policy management, sound fiscal positions and sizeable foreign exchange reserves have helped soften the impact of global recession in 2009 on the region. Supported by sound economic fundamentals and rapid industrialisation, the longer term economic prospects for Asia are bright.

As standards of living improve across Asia, the emerging middle class will demand more of education, leisure and better health care, improving the prospects for Australian exports, and providing more opportunities to a wide range of businesses including from the financial, pharmaceutical, construction and engineering sectors.

While the emergence of new production capacity in Asia may threaten the longer- term viability of some manufacturers in Australia, the vibrant consumer markets in these countries also represent new markets for Australian businesses.

The Australian Industry Group strongly urges the Australian Government to encourage and assist Australian businesses venture into Asian markets. Australia needs to cultivate its links with Asia, and develop an “Asia-ready” workforce. Australian industry must lift productivity, and the Australian Government could assist through continued investments in infrastructure, changes in policy to stimulate entrepreneurship, risk-taking, innovation and research and development, tax reforms and reductions in the regulatory burden on businesses. In addition to removing trade barriers, the Australian Government could also assist by enhancing schemes designed to promote Australian exports.

Australia’s economic prospects could be bolstered through greater trade and financial linkages with Asia. Businesses would benefit by seizing the numerous opportunities available in the region, and their chances of success would be increased with governments, businesses, industry groups and unions working in unison.



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## Executive Summary

Much of the next decade is likely to be characterised by slow rates of growth in the major developed economies, reflecting significant financial and fiscal imbalances. In contrast, economic growth in Asia led by China is widely anticipated to remain robust, lifting the prominence of Asia in the global economy.

It is imperative that Australia secures its economic future by increasing its trade links with Asia and by building into investment decisions the emerging opportunities in Asia. At the same time Australia should continue its economic engagement with the developed economies in the West through trade, finance, tourism and technological transfers.

Some of the major trends emerging in Asian economies include the expansion of an increasingly affluent middle class, an ageing population, the formation of a regional supply chain, the rise in intra-Asia trade and the prospect of the rise of the Renminbi as an internationally traded currency. These trends present numerous opportunities for Australian businesses.

As living standards improve across Asia, the emerging middle class will demand more of education, leisure and better health care, boosting the prospects of Australian education, tourism and medical tourism exports.

The Asian pharmaceutical market is set for significant growth following the ageing of the population in the region, and this is a sizeable market for Australian pharmaceutical and health care product suppliers to target.

Meanwhile, Australian construction and engineering businesses could also seize the opportunities presented by rapid urbanisation occurring in Asia, as this would necessitate the commencement of many infrastructure and construction projects in new and expanding Asian cities.

Although the emergence of new production capacity in Asia, such as in Vietnam and Indonesia, could threaten the longer term viability of some manufacturers in Australia, the vibrant consumer markets in these countries also represent new consumer markets for Australian businesses. With value for money, good quality products and strategic marketing, Australian businesses may be able to gain market shares in these emerging economies.

With opportunities abounding in Asia, the chances of success by Australian businesses would be bolstered by well-targeted and well-funded training and assistance programmes from the Federal and State Governments. Australia needs to develop executives that are in tune with the culture, politics, languages and business practices in Asia. Also there is a case for extending funding aimed at boosting attempts by business to gain a foothold in Asian export markets.

The future for Australian businesses in Asia is bright, and businesses, governments, industry groups and unions should work in unison to seize the numerous opportunities offered by the fastest growing region in the decades ahead.

## Key Policy Recommendations

- The Australian Government should actively cultivate its links with Asia, forming networks with policymakers at the central, state and provincial levels, as well as with members of various business communities.
- Engage Asian business specialists to advise Australian policymakers and to train senior and middle management executives on investing in Asia. Such schemes could build on and expand existing assistance programmes, such as TradeStart.
- Encourage Australian businesses to send their executives for training on various aspects of doing business in Asia by offering tax rebates on such investments. These could include professional training programmes conducted by universities and other educational establishments in Asia.
- Increase investments in education and training initiatives that would help develop an “Asia-ready” workforce that is highly capable, creative, adaptable, technically skilled and well-versed in the various cultural, bureaucratic, political, linguistic and business ways of the various economies in Asia.
- Enhance the benefits derived from Asian immigration in building networks and links between Asia and Australia through the introduction of a new Colombo Plan scholarship.
- Increase funding for organising international forums to promote and facilitate business-to-business exchanges at all levels. Australian businesses could be encouraged to adopt mentoring partnerships with successful, respected and experienced companies with good links and reputation with governments and local businesses in Asian economies. There are also successful Australian businesses in Asia that could share their stories of success and the pitfalls of doing business in Asia at the international forums.
- Facilitate travel by business people between Australia and Asian countries through streamlining and/or waiving visa requirements. Industry could benefit from increased support through programs like the APEC Business Travel Card.
- Lift the productivity of Australian businesses through continued investments to improve infrastructure, changes in policy to stimulate entrepreneurship, risk-taking, innovation and research and development, tax reforms and reductions in the regulatory burden on businesses, to enable them to compete more effectively in the Asian markets.
- Enhance the Export Market Development Grant scheme by increasing Government funding for eligible export promotion expenses, as well as increase the number of times funding may be obtained by each eligible applicant.
- Conduct more trade missions that are targeted at specific geographical areas and economic sectors.
- A continued concerted effort should be put into removing and reducing regulatory restrictions and barriers to two-way trade and investment in Asia. In addition, behind-the-border trade restrictions must be tackled through appropriate channels including the World Trade Organisation.
- Encourage and facilitate closer coordination and collaboration between the Federal and State Governments in trade and investment promotional tours in Asia.

## Economic Outlook

The major developed economies, including the US, Japan and parts of Europe, will continue to have a strong influence on the global economy through their technological leadership, contribution to world growth, accumulated wealth and prominence in world financial markets. Nevertheless, structural weakness in these economies, in the form of significant financial and fiscal imbalances and, in parts of Europe, weak international competitiveness, will take many years to resolve.

Much of the next decade is therefore, likely to be characterised by slow rates of growth in the major developed economies, with higher macroeconomic volatility. In contrast, economic growth in Asia led by China is widely anticipated to remain robust.

Prospects remain positive for Australian businesses with markets or investments in Asia. For example, packaging maker Amcor reported that its business in China is growing faster than the Chinese economy, and that other emerging markets in Asia are growing strongly. Amcor has 21 per cent of its portfolio in emerging markets, particularly in Asia, and sales growth in Asia hit 15 per cent in the second half of 2011.<sup>1</sup> Amcor is pursuing more opportunities in the north and east of China.

Australian businesses with investments in Asia are likely to continue hiring and expanding, although with some caution given the unpredictable global conditions. There would also be continued demand from Asia for Australia's services - in finance, logistics and tourism. Taken as a whole, Asia is providing some lift to the Australian economy at a time of continuing economic weakness in the US, Japan and Europe.

It is therefore imperative that Australia secures its economic future by increasing its trade links with Asia and investing more in emerging strategic industries in the region, while continuing its economic engagement with the developed economies in the West through trade, finance, tourism and technological transfers.

In order to succeed in engaging Asian economies, Australia needs to comprehend the economic trends emerging in Asia, as well as the challenges and opportunities that these trends pose for Australian businesses. Having done so, the Australian Government would then be able to formulate a set of well-targeted policies to assist businesses in seizing opportunities in Asia.

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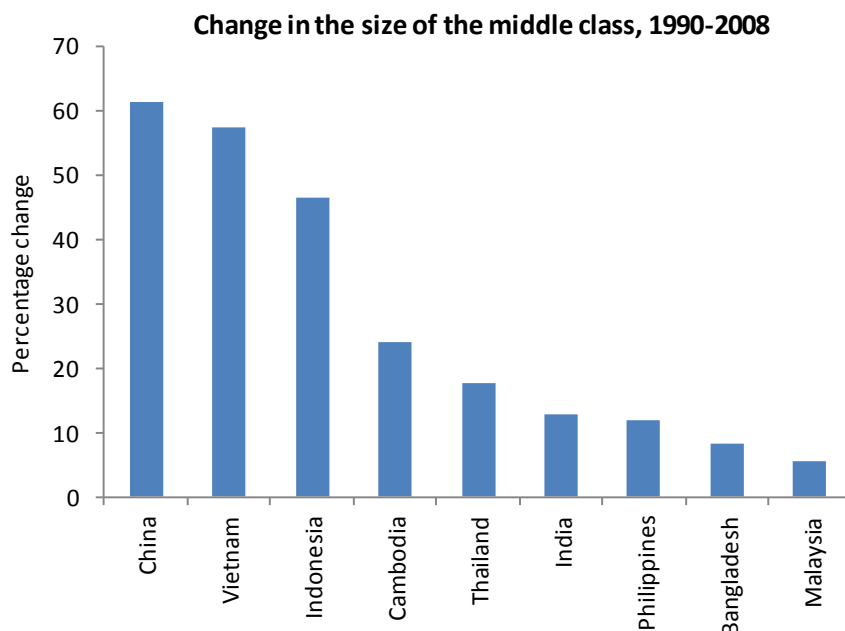
<sup>1</sup> Herald Sun, 20 February 2012.

## Trends in Asian Economies

### Expanding middle class

Robust economic growth in Asia over the last two decades has led to the emergence of a sizeable middle class in the region. Research conducted by staff from the Asian Development Bank shows that while developing Asia's middle class accounted for only 21 per cent of the population of developing Asian countries in 1990, it has more than doubled to 56 per cent by 2008; up more than three-fold from 565 million in 1990 to 1.9 billion in 2008 in absolute terms, with the strong growth led by China (Chart 1).<sup>2</sup> By 2030, the share of the middle class in developing Asia's population is forecast to reach 59 per cent, with those in this income bracket spending \$6.6 trillion annually. This expenditure is twice the level in 2008 and almost twenty-fold the amount forecast for OECD (Chart 2).

**Chart 1: Change in the size of the middle class in selected Asian economies**



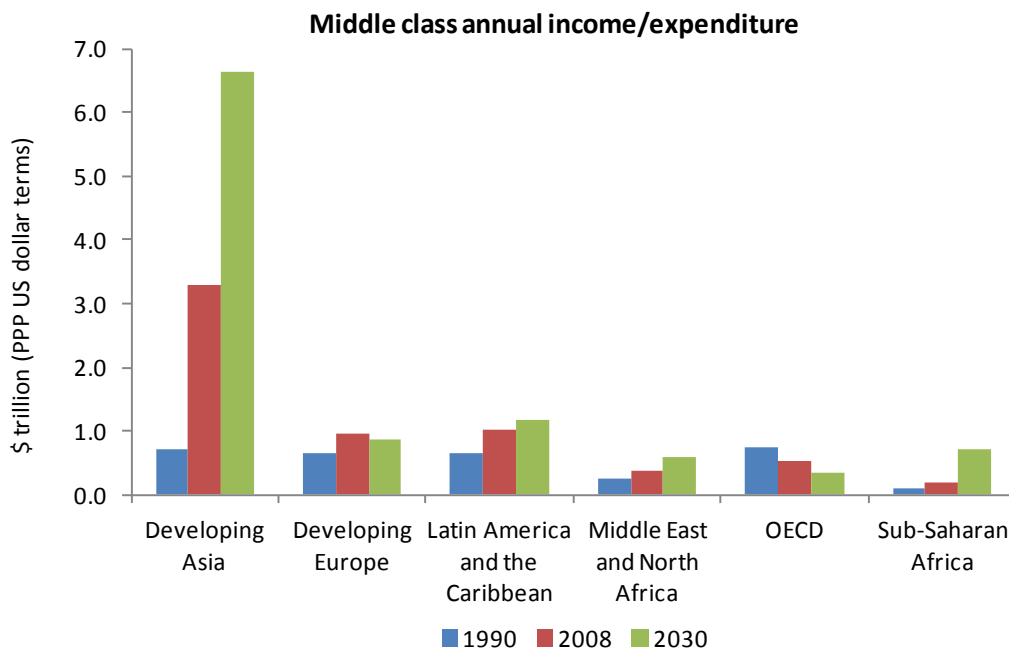
Source: Chun (2010)

Rapid urbanisation in Asia has reduced the income gap among Asians, led to the emergence of a middle class and lifted consumption. This would, in turn, further spur economic growth and support consumption by existing city dwellers and new migrants, as well as making it easier to reach more consumers, creating huge potential opportunities for businesses. Consequently, businesses in Asia could increasingly target the Asian market, selling more to Asian consumers rather than exporting to developed economies where growth is widely anticipated to remain subdued due to public and household debt deleveraging.

<sup>2</sup> The people in the middle class are defined as those with consumption expenditures of \$2–\$20 per person per day in 2005 purchasing power parity US dollar terms. In addition, countries included in developing Asia are Armenia, Azerbaijan, Bangladesh, Cambodia, People's Republic of China, Georgia, India, Indonesia, Kazakhstan, Kyrgyz Republic, Lao People's Democratic Republic, Malaysia, Mongolia, Nepal, Pakistan, Philippines, Sri Lanka, Tajikistan, Thailand, Turkmenistan, Uzbekistan, Viet Nam. Source: Chun (2010).

The emerging middle class in Asia is a very significant consumer market for Australian businesses. As the size of the Asian middle class expands and incomes rise, they are likely to consume more of education and high-end manufactured products as well as spend more on holidays. Also, members of the middle class have more opportunities for a protein-rich diet. These developments may boost Australia’s education, tourism and agricultural exports.

**Chart 2: Change in middle class annual expenditure in various regions**



Source: Chun (2010)

Reflecting on the vast potential of the Chinese market, Minister Craig Emerson mentioned in a speech made in late 2011 that recently completed Austrade research finds that Australian exports of sophisticated manufactured goods to China increased by 243 per cent during the last decade, reaching almost A\$2 billion in 2010, compared with a fall of around 20 per cent in such exports to both the United States and Britain.

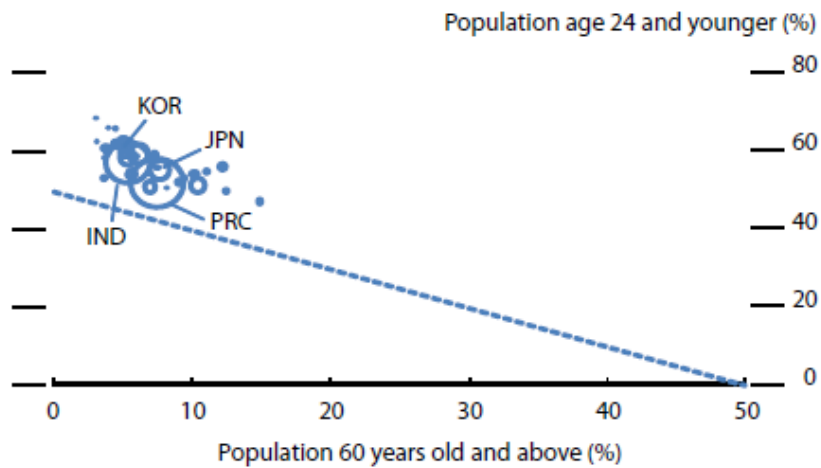
### **Ageing population**

Important changes in Asia’s age structure began to take place as early as 1950. Then, the age distributions of most Asian countries were heavily concentrated among the young, with the majority of Asians under age 25. The proportions of the age 60 and older group ranged from a mere 3 per cent to 15 per cent (Chart 3).<sup>3</sup>

<sup>3</sup> In Charts 3 to 5, the horizontal axes measure the population share of individuals age 60 and older, while the vertical axes measures the corresponding proportion of persons age 24 and younger. The diagonal gridline consists of the locus of points for which the population shares of the elderly and the young sum to 50 per cent with the other half of the population comprised of people of working age.



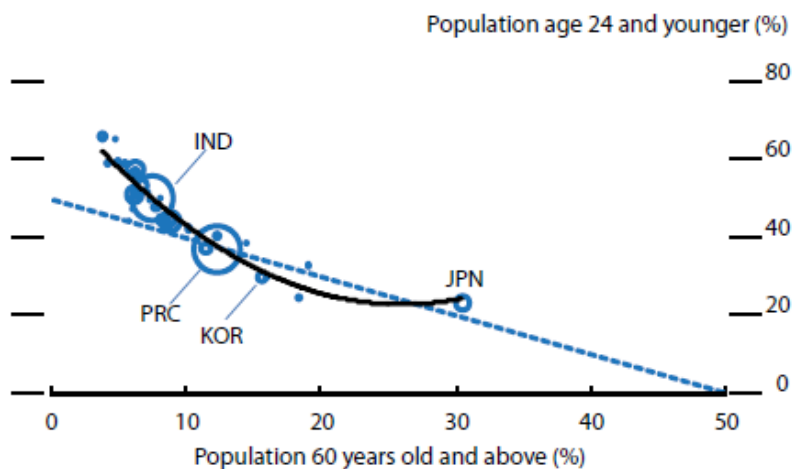
**Chart 3: Population age structure in Asia in 1950**



Source: Asian Development Bank (2011)

In contrast, the population age profiles of Asian countries became more heterogeneous by 2010. The share of Asians age under 25 has generally declined and the share of Asians age 60 and above has increased, pointing to an ageing population (Chart 4). At this point, Japan has become an outlier with its population having aged most rapidly.

**Chart 4: Population age structure in Asia in 2010**

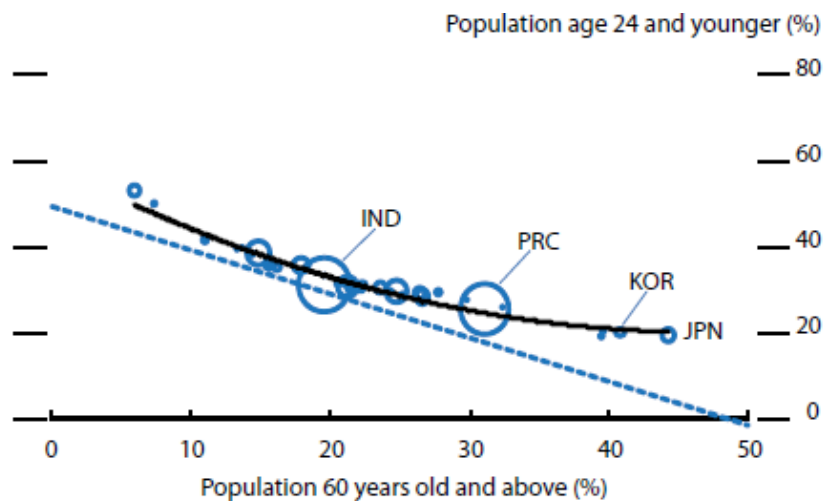


PRC = People's Rep. of China; IND = India; JPN = Japan; KOR = Rep. of Korea.

Source: Asian Development Bank (2011)

The trend of an ageing Asian population is expected to continue. Between 2010 and 2050, the populations of Asian countries will age quickly, as rapid declines in fertility diminishes the sizes of the age 24 and younger population relative to the total population quickly (Chart 5). With the population shares of the younger cohorts becoming smaller, as the cohorts age and reach the prime working ages, the decreasing number of new entrants into the working-age category will result in a larger share of the elderly in the total population and a smaller share of the youths in total population. Chart 6 summarises the evolving demographic trends in Asia.

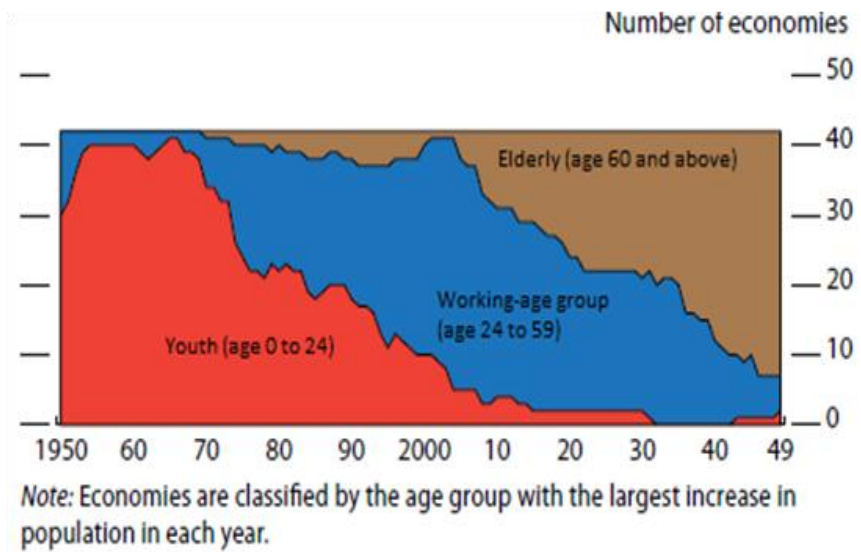
**Chart 5: Population age structure in Asia in 2050**



PRC = People's Rep. of China; IND = India; JPN = Japan; KOR = Rep. of Korea.

Source: Asian Development Bank (2011)

**Chart 6: Changing age profile of the Asian population**



Source: Asian Development Bank (2011)

An ageing Asian population means that the consumption pattern in Asia could evolve towards more expenditure on health care products and services, a trend which may benefit Australian health care providers and pharmaceutical businesses. In addition, the declining labour force in Asia implies that Asia's businesses investments may taper off over time.

These developments add uncertainty to the longer term outlook for domestic demand in Asia, and casts doubt about whether Asia will be able to sustain its impressive economic growth rates in the decades ahead. Research from the Asian Development Bank suggests that the ageing Asian population would reduce economic growth in the region. For example, the ageing population in

China is forecast to reduce China’s GDP per capita growth by 0.8 percentage points in the period from 2021 to 2030 (Table 1).

**Table 1: Impact of ageing population in growth (percentage points of GDP per capita growth)**

	1981-1990	1991-2000	2001-2010	2011-2020	2021-2030
China	2.1	0.6	0.7	0.2	-0.8
Hong Kong	1.1	0.3	0.4	-0.1	-2.2
India	0.4	0.6	0.7	1.0	0.5
Indonesia	1.1	1.4	0.8	0.6	0.2
Korea	2.1	1.1	0.0	-0.1	-1.4
Malaysia	1.2	0.9	1.0	0.6	0.1
Philippines	0.9	0.8	0.9	0.8	0.4
Singapore	1.8	0.1	-0.1	-0.1	-2.5
Thailand	2.5	1.5	0.5	0.1	-0.9
Vietnam	1.1	1.2	1.7	1.5	-0.3

Source: Asian Development Bank (2011)

### *Integrated Asian supply chain network*

Rising production costs in China in recent years, especially labour costs, have prompted some manufacturers to restructure part of their production arrangements to take advantage of the lower labour costs of other Asian economies in producing some of the labour-intensive and less sophisticated items.<sup>4</sup>

Since 2010, 30 Chinese provinces have raised their minimum wages, by an average of 23 per cent, and factory owners in the Pearl River Delta export belt surrounding Hong Kong are increasing pay by much more than that to keep their assembly lines running. In 2010 the minimum wage in Beijing went up by over 45 per cent, thanks largely to the booming economy and tightening labour supply.<sup>5</sup>

In response to higher labour costs, businesses are beginning to adopt the “China plus one” strategy, which involves a division of labour among different Asian production bases that are evolving into a network of suppliers of different strata. The emerging Asian production bases, such as Vietnam, are supplementing China in fulfilling part of the overseas demand for, in particular, labour intensive goods as China expands further into higher value-added products and upstream industries.

The phenomenon of businesses shifting part of their production of mass market, lower-priced items to other Asian countries while concentrating their higher value-added manufacturing in China has been given further impetus from the Chinese Government’s 12<sup>th</sup> Five-Year Plan (FYP). The FYP includes a target of boosting domestic consumption by lifting minimum wages by at least 13 per cent a year for 2011 to 2015.<sup>6</sup> This policy, together with an already tightening labour market, means that wages in China are likely to increase at a still faster pace, speeding up the drift of labour intensive

<sup>4</sup> According to a survey by Japan External Trade Organisation of Japanese operations in the Asian region in 2009, the average actual wage paid by Japanese companies to manufacturing workers in China was about US\$4,000 a year, while the level was about US\$2,000 in Vietnam and about US\$1,000 in Bangladesh.

<sup>5</sup> Economist Intelligence Unit (2011)

<sup>6</sup> Economist Intelligence Unit (2011)

manufacturing from China to other Asian economies. Furthermore, the Chinese Government has explicitly encouraged the development of high technology, high value-added manufacturing in China through tax and funding initiatives announced in its 12<sup>th</sup> FYP.

The trend towards adopting the “China plus one” strategy does not, however, suggest that the Chinese economy is uncompetitive relative to the other Asian economies. China’s impressive exports performance suggests that China’s competitiveness does not rest only on costs.

Despite rising production costs and the Renminbi appreciation in recent times, China’s share of manufactured exports in world trade continued to increase, from 4.7 per cent in 2000 to 12.7 per cent in 2008, according to the World Trade Organisation (WTO).<sup>7</sup> Though exports of some other emerging Asian production bases are also increasing rapidly, their relatively small share in world trade suggests that their overall export capacities as well as product diversity are lagging far behind that of China. For example, Vietnam’s exports to the US and EU grew rapidly by 18.8 per cent and 9.3 per cent respectively between 2006 and 2009, but its shares in both the US and EU market remained low at 0.9 per cent.<sup>8</sup>

The competitiveness of China as a production base depends on price and an integrated bundle of factors such as quality-price ratio of the output, infrastructure support, delivery lead time as well as flexibility in meeting different specific order requirements.

Furthermore, China’s higher labour cost may be justified by its higher skill level and productivity. Estimates show that the average output per worker in the manufacturing sector of China is significantly higher than that of Vietnam and India. Labour productivity growth (defined as real GDP per worker) of China’s manufacturing sector has also been among the highest in emerging Asian production bases (Chart 7).

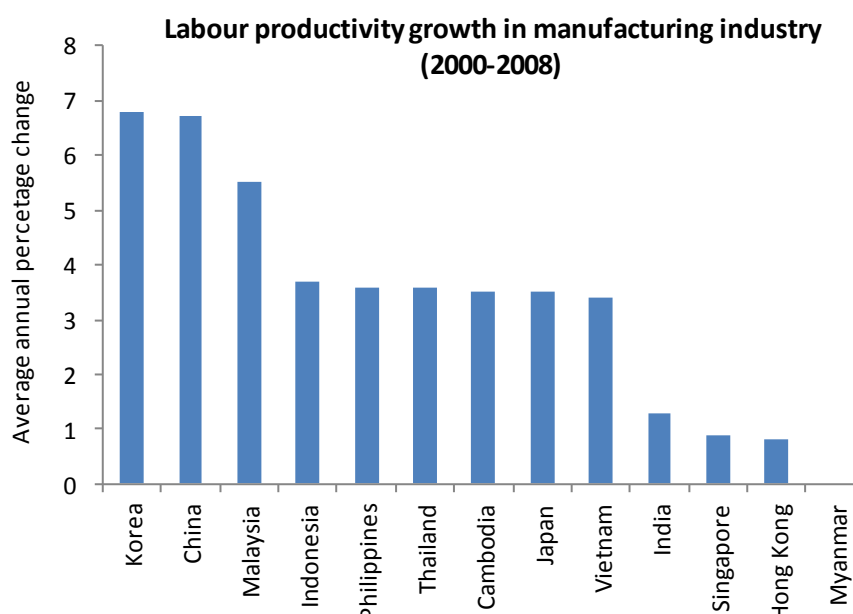
Besides the skills of labour, there are other factors affecting productivity. Manufacturers in China benefit significantly from the well-developed industrial clusters where upstream supplies can easily be sourced locally and essential services such as freight forwarding and laboratory testing are available. With ample supply of both upstream and downstream products, businesses are assured a strong supply chain as they can easily find supporting industries, products and spare parts locally. This would lower production costs, increase efficiency and shorten the delivery time for businesses in China.

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<sup>7</sup> Hong Kong Trade Development Council website

<sup>8</sup> Hong Kong Trade Development Council website

**Chart 7: Labour productivity in manufacturing industries of selected Asian economies**



Source: Asian Productivity Organisation (2011)

China is likely to remain a competitive production base in the medium term, but increasingly less so in labour intensive manufacturing. However, as the increase in Chinese wages picks up speed over time, businesses in Asia may increasingly relocate more of their labour intensive manufacturing to other Asian economies, where there exists political stability and sizeable and buoyant consumer markets, while retaining and growing their higher value-added operations in China. The formation of such an integrated supply chain network within Asia would further enhance intra-Asia trade.

#### *Rise in intra-Asian trade*

Asia is a world-leading source of exports, but the most striking trend is the rapid growth in intra-regional trade. While global trade and Asia's trade with economies outside the region have doubled since 2000, intra-Asia trade has tripled. As a result, Asian economies accounted for 35 per cent of world exports in 2009, compared with 25 per cent 10 years earlier, with the share of intra-regional exports rising to 55 per cent from 45 per cent over the same period.<sup>9</sup>

Intermediate goods exports have accounted for about 70 per cent of the annual export growth in Asia over the last decade—more than double the contribution of capital and consumer goods. This has been particularly the case for ASEAN, the NIEs, and Japan.

As a result, intra-Asia exports are more intensive in intermediate goods than are other exports. The average share of intermediate goods exports between Asian trading partners has increased to nearly 80 per cent in 2009 from about 60 per cent a decade earlier.

Asian economies have increasingly formed a supply network. Consequently, direct export competition has been accompanied by trade partnerships. For Asia, excluding China, the share of

<sup>9</sup> International Monetary Fund (2011a)

intermediate goods exports to China in total exports has doubled over the last decade, whereas the share of direct consumer goods exports to the United States and Euro area has steadily declined.

Research conducted by the International Monetary Fund (IMF) shows that China ultimately accounts for about 50 per cent of all trade flows in imported inputs in Asia, more than double its share in 1995. China has become, for many of its Asian trading partners, the single most important destination of intermediate goods exports. The predominant intermediate goods suppliers to China have consistently been Japan, Korea and Taiwan, accounting for almost 80 per cent of China's imported inputs.

In addition, China's role as a supplier to other Asian economies has also rapidly grown. China's share in direct and indirect intermediate goods exports within Asia has doubled to nearly 30 per cent in 2009, from 15 per cent a decade earlier.

As a result of growing integration, the competitiveness of Asian economies depends not only on movements of their own currencies, but also of the currencies of their suppliers. This means that the price of exports to the final market (for example, the United States) would rise by more if the exchange rates of both the final exporter and its suppliers appreciate (*vis-à-vis* the currency of the final market) than if the exchange rate of only the final exporter appreciates.

The rise in intra-Asia trade offers new export markets for Asian economies, but at the same time increases the susceptibility of each country to an economic downturn in the neighbouring countries. In addition, businesses operating in Asia would need to be more vigilant in monitoring fluctuations in Asian currencies, and this could generate more currency hedging related businesses for financial institutions. This may become an emerging business area for Australian financial institutions.

### *Reminbi as an internationally traded currency*

China is currently the world's second largest economy, yet the Renminbi is only the 17<sup>th</sup> most traded currency.<sup>10</sup> The offshore Reminbi market is therefore likely to continue to grow as China encourages more cross-border trade. The market is also likely to receive a boost from foreign investors seeking to take advantage of further liberalisations of the Renminbi market and as a broader range of asset classes are being traded.

Following a rise in the use of the Renminbi in international trade as well as the inevitable removal of capital controls in China, Asian central banks could diversify away from US dollar denominated assets and also hold Renminbi denominated assets as part of their management of international reserves. This would help Asian economies reduce their vulnerability to a possible sovereign debt crisis in the US.

In 2004, Hong Kong was the first jurisdiction to be allowed the accumulation of Renminbi outside mainland China. Following the rapid development of trade and financial linkages between Hong Kong and mainland China, the Renminbi became officially tradeable in Hong Kong in 2010.<sup>11</sup>

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<sup>10</sup> Royal Bank of Scotland (2011)

<sup>11</sup> Hong Kong and Shanghai Banking Corporation (2010)

The internationalisation of the Renminbi may see China allow more Renminbi offshore centres. China has recently stated it would support an offshore Renminbi trading market in London, while Singapore is also another possibility.

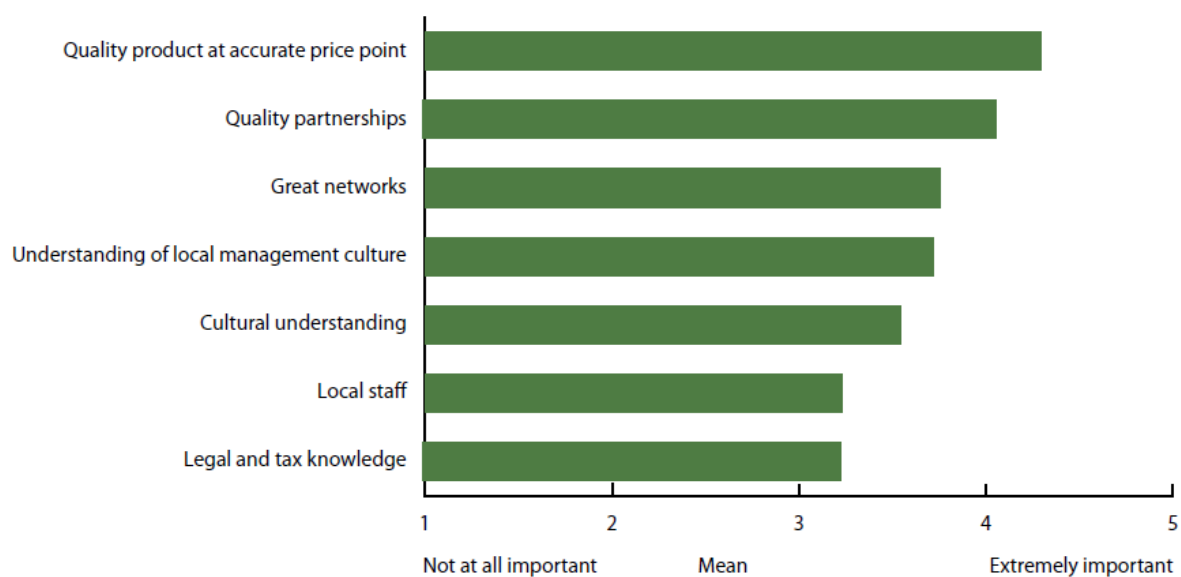
Given the deepening and broadening of trade and financial linkages between Australia and China, and Asia more generally, it may be worthwhile for the Australian financial sector to develop as an offshore Renminbi trading centre. This would help generate more employment opportunities in the Australian economy, propel economic growth in Australia and facilitate businesses manage foreign currency risk exposures.

## Opportunities for Australia

### *Emerging Asian middle class offers greater opportunities to boost exports of educational services*

The rising middle class in Asia is likely to spend more on children's education, and this presents many opportunities for education providers in Australia. Australia could establish programmes to train Asian students at Australian universities and other educational institutions, and in doing so boosting Australia's services exports. These programmes could be expanded to include exchange programmes, such that Australian students could also study in Asian universities. This would help Australians develop deeper understanding of Asian culture and business practices, and likewise for Asian students. This means that the future cohorts of Australian executives would be well informed about the Asian culture and business practices, facilitating upcoming Australian businesses in gaining a foothold in Asian markets. A survey of Australian businesses engaged in or with Asia conducted by Ai Group and Asialink in 2011 showed that the understanding of local management culture and cultural understanding are considered very important factors determining business success (Chart 8).

**Chart 8: Importance of factors in doing business in or with Asia**



Source: Australian Industry Group and Asialink (2011)

Rapidly developing emerging Asian economies need to establish strong government institutions, and Australia could establish programmes to train mid- to high-level Asian government officials in areas such as urban planning and public administration. This would not only help to lift Australia's services exports but also enables the formation of crucial networks at high levels of government across Asia, another very important factor determining business success (Chart 8). These networks may prove useful when negotiations with government officials are needed as Australian businesses enter Asian markets.

The opportunity afforded by education and training extends beyond the provision of services. Australia has a well-regarded and mature education and training system. The current policy



architecture serves our domestic arrangements effectively and it has allowed for the development of education as an export market. However, as Asian nations further develop their own internal education and training arrangements, the need for and attractiveness Australian of provision may shift or decline. Thoughtful development of the policy architecture of the Australian education and training systems could position Australia at the heart of human capital development in the Asia Pacific region. Australia is unique in having long standing qualifications framework. Whilst this framework has recently undergone revision progress should not stop. The opportunity to drive the development of an Asia-Pacific Qualifications Framework, at a meta level, should be seized.

In addition to this, the development of trans-national competency standards, as they relate to the training system should also be pursued. Australia has a well-developed system of identifying and developing competency standards across the economy. These form the basis for training packages and qualifications that drive skill development in our training system. Many countries have expressed interest in our industry-based approach to skill development and standard setting. The development of trans-national standards in critical occupational areas would be astute. This approach would assist in labour mobility and other recognition issues. Industry Skills Councils currently have carriage of undertaking this development within the Australian context. The remit of these councils could be broadened. These councils could also act as co-ordination points for a range of education and training issues and opportunities across the region. The Indian government is currently establishing its own sectoral councils. It is drawing upon the Australian model and Australian expertise.

#### *Ageing Asian population offers opportunities for Australian businesses in many sectors*

The ageing Asian population means that Asian economies will increasingly need to establish robust social security systems and encourage their people to save and invest more for their old age. This presents significant business opportunities for the Australian funds management industry as Asian government and private sector pension funds could farm out more funds to be invested by Australian fund managers both in Australia and abroad. In addition, Asian families could start to explore alternative channels of investing their savings through Australian fund managers, thus boosting the Australian financial sector and generating more employment opportunities in Australia.

The ageing population in Asia also means that Asian economies would need to invest more in physical and human capital to lift productivity as a means to maintain economic growth rates in spite of a shrinking working-age population. Significant infrastructure investments in Asia would clearly be a plus to the Australian mining sector as a relatively low-cost supplier of raw materials. Human capital development in Asia could help lift Australia's education (services) exports as more Asians come to Australia for their education.

Australia could also promote medical tourism to benefit from the increasingly affluent but ageing Asian population's demand for high quality health care. Australia is renowned for developing world leading health care products, innovation in medical research and as a location for specialised medical procedures. As living standards improve across Asia, better quality healthcare would be demanded by the growing Asian middle class. They would want better equipment, better hospitals, and better preventative health strategies, all of which could be sold and exported by Australia.

### *Emerging opportunities in the Asian pharmaceutical and healthcare markets*

Along with an ageing population, the pharmaceutical market in China and Asia has a lot of potential to develop and it could serve as a very important growth area for healthcare equipment and service providers and pharmaceutical businesses in Australia in the decades ahead.

Cochlear is an example of an Australian health care equipment business that has successfully seized opportunities in Asia. In financial year 2010-11, Cochlear's revenue in the Asia Pacific region grew 31 per cent to a record \$122 million and it was the standout region in the year. Growth was driven by strong Cochlear implant sales in the emerging markets, in particular India and China.

The Chinese Government has pledged to pursue healthcare reform, in part to give a much-needed boost to the quality of life of many of its citizens. Patients in many rural areas currently have only limited access to clinics, drugs and health insurance. In addition, city dwellers must often cope with overcrowded hospitals and overstretched doctors. Rural and urban residents alike must pay a big portion of medical bills themselves.

It may be a long time before any healthcare reforms will bear fruit in China. Nonetheless, China's healthcare market is already huge and would become larger. Health insurance and the provision of more healthcare facilities across the country are much needed.

China is a top-ten market for pharmaceuticals in the world, with US\$42 billion worth of drugs sold in 2010 according to IMS, a healthcare consultancy. Much of the spending was on cheap, domestically made generic drugs and the market grew at an annual average of around 6 per cent during 2006 to 2010. This pace is expected to continue through 2015, as incomes rise, the government spends more and the ranks of the elderly swell. By then, China may become the world's second-largest pharmaceutical market, after the US.<sup>12</sup>

### *Integration of Australian business into Asia*

As elaborated earlier, businesses operating in Asia are beginning to adopt the "China plus one" strategy of relocating labour intensive manufacturing to other Asian economies while retaining high technology, high value-added manufacturing in China. This trend is set to continue given rapid increases in wage pressures in China.

Many Australian businesses are already well-advanced in equivalent strategies through which they combine Australian-based capabilities with those more competitively available in Asia to boost the competitiveness of their goods and services both in Asian and other markets (including the Australian domestic market).

In some cases, Australian manufacturers retain cost competitiveness by taking advantage of the strong Australian dollar and import component parts from Asia. In others, Australia's strength in design capabilities and quality production, mean that Australian businesses combine their domestic R&D and design capabilities with lower-cost production in Asia as a means of increasing competitiveness in export markets.

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<sup>12</sup> Economist Intelligence Unit (2011)

These and similar strategies involving greater integration of Australian businesses and their supply-chains with Asia offers considerable advantages across a very broad spectrum of businesses.

### *Attracting more foreign investment from Asia into Australia*

Australia has been running a current account deficit for decades, reflecting its heavy reliance on the rest of the world for capital. With Asia booming, Australia could consider enticing more foreign investment from Asia into Australia, especially to spearhead developments of industries, such as high-technology manufacturing where bank funding is limited due to the inherently higher risk associated with young technology start-ups. Australia may even encourage the establishment of Asian venture capital funds in Australia.

### *Emerging low cost production bases and new consumer markets in Asia*

With wage increases and hiring difficulties experienced in the more developed regions of China, some Australian manufacturers may consider relocating production sites to other Asian economies, such as Indonesia and Vietnam, where there are relatively low cost labour and buoyant consumer markets.

Despite the global financial crisis, **Indonesia** recorded strong economic growth of 4.5 per cent in 2009. In 2010, the economy expanded 6.1 per cent. A healthier banking system since the Asian financial crisis in 1997, increasing macroeconomic stability and strong consumer confidence shielded Indonesia from the global recession in 2009. Indonesia's economic expansion is likely to continue. The IMF projects Indonesia's economic growth to exceed 6 per cent, ahead of ASEAN's average economic growth in coming years.

Given its robust economic performance, Indonesia has gained the attention of many overseas investors. The IMF forecast net foreign direct investment in Indonesia to exceed US\$14 billion in 2011, significantly higher than the US\$9 billion recorded just prior to the global financial crisis. In 2012, Indonesia's net foreign direct investment is expected to remain around US\$14 billion. Foreign investors are attracted by Indonesia's large consumer base, low labour cost and profitable commodity projects.

The Indonesian Government recently released a plan<sup>13</sup> to make Indonesia one of the world's largest economies by 2025. The first pillar of the plan is the development of six regional economic corridors through investments in sectors with high growth prospects and clear comparative advantages. This would be supported by the second and third pillars, namely improving connectivity and strengthening human resources and science and technology. The plan targets investments of US\$468 billion over 2011–2025, of which 45 per cent will be in infrastructure. One fifth of the total investment is expected to come from the Government.<sup>14</sup>

President Yudhoyono government's commitment to create a secure and investment-friendly business environment for foreign investors is the key to success. Moreover, government policies towards foreign direct investments are becoming more favourable. Under revised laws, foreign and domestic investors are given equal legal status and treatments, except in sectors under the Negative

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<sup>13</sup> Master Plan for the Acceleration and Expansion of Indonesia Economic Development 2011-2025.

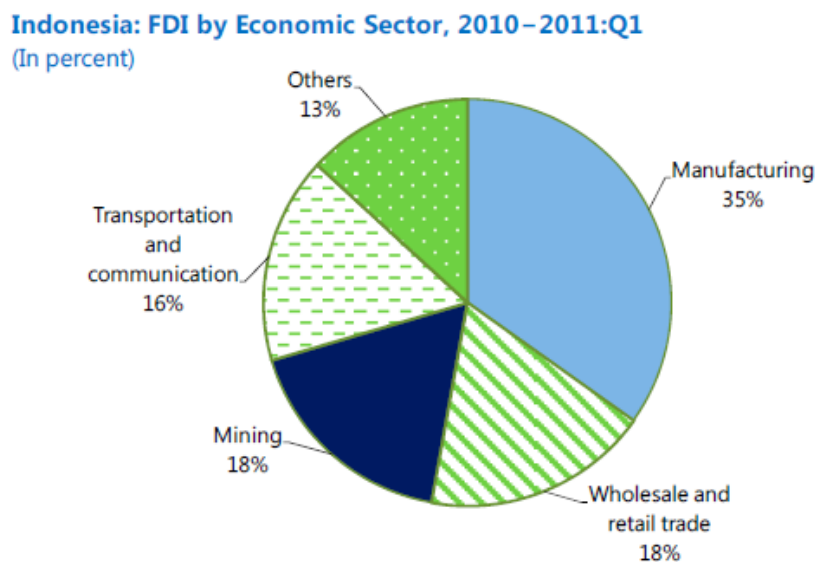
<sup>14</sup> International Monetary Fund (2011b)

Investment List, which has also been streamlined by the Indonesian government. Corruption and government bureaucracy have reportedly showed signs of improvement over the past few years.

The manufacturing industry accounted for more than one third of all the foreign direct investment in Indonesia over the period from 2010 to the March quarter of 2011 (Chart 9). This suggests that the prospect for manufacturing in Indonesia is positive and there may exist opportunities for Australian manufacturers in Indonesia.

Increasing manufacturing activities in Indonesia are driving up the demand for electronic components, leading to a supply-demand gap. To avoid direct competition with those high-priced multinational brands and relatively low-priced Chinese products, Australian businesses may find opportunities in supplying mid-range quality and less complex electronic parts.

**Chart 9: Foreign direct investment in Indonesia**



Source: Bank Indonesia.

Source: International Monetary Fund (2011b)

Rising middle-class families and emerging young consumers have boosted the “good-enough market”, which is a market characterised by consumers looking for “reliable-enough” products at a “low-enough” price. Known for “good quality” and “value for money”, Australian brands and products could find competitive advantages in this emerging market.

Given the fierce competition in prime locations in department stores and shopping malls, it may be easier for Australian brands to gain market access by partnering with local companies with strong local business networks. Australian brands could also link up with local department stores, which want new brands in a bid to differentiate themselves from their competitors.

Increasing prosperity in Indonesia is leading to a booming demand for consumer food services. Overseas companies, particularly those from Singapore and the US, have been very aggressive tapping into the Indonesian market. Australian consumer food services suppliers should be more proactive in exploring opportunities there. Indeed, franchising can be a cost-effective expansionary strategy, with less financial risk.

For Australian manufacturers with limited knowledge of doing business in Indonesia, they could consider moving into industrial estates, which provide “one-stop service”, including land, buildings, logistics, water and electricity supply.

In addition to Indonesia, **Vietnam** is another promising emerging market in Southeast Asia. Its economy expanded 5.3 per cent and 6.8 per cent in 2009 and 2010, respectively, despite the global financial crisis. Key drivers of the country’s economic growth include a strong export sector supported by the abundance of relatively low-cost young labour, rising purchasing power of consumers and geographic proximity to China. As Vietnam gradually opens its economy according to its WTO commitments, new business opportunities may emerge.

While most other Asian nations recorded significant declines in their external trade amid the global financial crisis, Vietnam’s trade performance was comparatively healthy, with exports and imports estimated to have fallen 8.9 per cent and 13.3 per cent respectively, an indication of the competitiveness of many Vietnamese products in the international market. The decrease in external demand had a lower impact on Vietnam compared to other export-oriented Southeast Asian countries, even though its export sector accounts for around 60 per cent of GDP.

Rapid growth of Vietnam’s economy and its export sector has boosted income. The surge in spending power, along with accelerating urbanisation, makes the country attractive to foreign retailers. As consumer preferences are gradually shifting from price to quality, many middle-class and affluent Vietnamese consumers are looking for quality imported goods, such as food, beauty and healthcare, fashion, and electronic products. Given a young population, growing middle-income class, increasing brand awareness and in particular, modernisation of retail channels, Vietnam’s retail market is expected to maintain the high growth in the next decade, creating opportunities for many Australian products, such as fashion and consumer electrical appliances.

#### *Urbanisation in Asia offers opportunities for Australian construction and engineering businesses*

Urbanisation in Asia is occurring rapidly. Research conducted by the Asian Development Bank indicates that the urban population in Asia could increase by 71 per cent between 2005 and 2030 (Table 2). The rapid development of cities that follows from such rural-urban migration presents significant opportunities for Australian construction and engineering businesses.

For example in China, the Government forecast that the rate of urbanisation would increase by 0.8 per cent to 1 per cent annually, leading to the migration of many millions of people from rural to urban areas in the decades ahead. This means that China’s cities would undergo significant development, and there would be strong demand for construction and engineering work.

Australian construction and engineering businesses could benefit from China’s urbanisation, and their business prospects would depend on, firstly, how China handles issues of growing urbanisation and, secondly, how they respond to competition from their mainland and overseas competitors.

China’s urbanisation strategy emphasises balanced development. Large-scale urbanisation leads to an influx of rural population to the urban areas, bringing immense pressure to the large cities. In order to reduce urbanisation’s impact on the large cities, China’s urbanisation strategy focuses on promoting the development of small and medium-sized cities, ensuring multi-faceted development of regional economies.

Small cities serve to absorb the rural population from the neighbouring areas, medium-sized cities act as the economic hinterland for large cities, and large cities function as hubs leading to the outside world. As small and medium-sized cities develop, their demand for the services provided by the large cities would grow. Thus, demand for technically demanding commercial and residential projects increases in large and medium-sized cities, offering business opportunities for Australian businesses.

Australian businesses face challenges from their mainland and overseas counterparts. Following years of increased exchanges between Chinese and foreign businesses, coupled with decades of experience, Chinese businesses are now more technologically advanced, while their costs remain relatively low. Furthermore, the huge size of the China market has attracted many international construction and engineering firms to compete at the high end of the market. Australian businesses would face increasing competitive pressure from all sides.

To respond to the competition, Australian construction and engineering businesses could actively pursue higher professional standards and offering high-value services targeted at clients at the high end of the market. For example, Australian businesses could apply environmental concepts to projects and help clients to reduce costs by suitable design and planning. Some Australian businesses may push for localisation by setting up subsidiaries in China and subcontract some of their work to these subsidiaries to reduce costs. Another advantage of localisation is that these businesses could have a better grasp of local developments and are in a better position to establish a local business network.

**Table 2: Urbanisation trends in Asia, 2005 to 2030**

	<b>GDP</b>	<b>Population</b>	<b>Urban</b>	<b>Proportion Urban</b>			<b>Estimated Increase in Urban Population</b>	
	<b>per capita</b>		<b>Population</b>					
	<b>(PPP, \$)</b>	<b>(million)</b>	<b>(million)</b>	<b>(%)</b>	<b>(%)</b>	<b>(%)</b>	<b>(million)</b>	<b>(%)</b>
	<b>2003</b>	<b>2005</b>	<b>2005</b>	<b>1950</b>	<b>2005</b>	<b>2030</b>	<b>2005–2030</b>	<b>2005–2030</b>
World		6,453.6	3,172.0	29	49	61	1,772.7	56
Asia		3,917.5	1,562.1	17	40	55	1,102.2	71
Malaysia	9,512	25.3	16.5	20	65	78	10.8	66
Thailand	7,595	64.1	20.8	17	33	47	14.6	70
PRC	5,003	1,322.3	536.0	13	41	61	341.6	64
Philippines	4,321	82.8	51.8	27	63	76	34.8	67
Sri Lanka	3,778	19.4	4.1	14	21	30	2.4	59
Indonesia	3,361	225.3	107.9	12	48	68	80.0	74
India	2,892	1,096.9	315.3	17	29	41	270.8	86
Viet Nam	2,490	83.6	22.3	12	27	43	24.5	110
Pakistan	2,097	161.2	56.1	18	35	50	79.3	141
Cambodia	2,078	14.8	2.9	10	20	37	5.8	197
Bangladesh	1,770	152.6	38.1	4	25	39	48.4	127
Lao PDR	1,759	5.9	1.3	7	22	38	2.3	177

GDP = gross domestic product, Lao PDR = Lao People's Democratic Republic, PPP = purchasing power parity, PRC = People's Republic of China.

Sources: United Nations, *World Population Prospects: The 2002 Revision*; *World Urbanization Prospects: The 2003 Revision*; and United Nations Development Programme, *Human Development Report 2005*.

Source: Asian Development Bank (2006)

Bluescope Steel's relatively strong performance in its China's business is an example of an Australian business growing on the basis of construction-related opportunities in a booming Asian economy. Its expansion in Xi'an is intended to enable it to capitalise on strong demand in Central and Western China.

### *Development of the "green economy" in China – opportunities for Australian businesses*

China's Government has committed to pursue urbanisation that emphasises environmental sustainability and the establishment of a green economy. As a result, energy efficiency, clean energy, and higher standards on water quality would become more important.

For example, the Guangdong provincial government has made the construction of a green and low-carbon economy a priority in the next decade. Consequently, the demand for services in energy conservation, emission reduction and pollution prevention from Pearl River Delta businesses has surged in recent years. Pearl River Delta businesses, particularly those in the manufacturing industry which accounts for over half of the province's total energy consumption, have strong demand for energy-saving services in areas like energy-efficient air-conditioning, recovery of residual heat and pressure, green lighting, power system enhancement and utilisation of new energy sources. Guangdong's energy-saving services market is estimated to be worth several billion a year. As the needs in the market cannot be fully met by Pearl River Delta's small and medium-sized service providers, opportunities in the market abound for Australian businesses.

These new challenges would be experienced throughout the major cities in China and they would spur the development of energy and environment related industries, including green vehicles, renewable energy, energy efficiency technology and services, gas purification, waste processing, sewage treatment, landscape gardening and water treatment. China needs advanced environmental technology, and Australian businesses with expertise in energy efficient and environmental friendly technologies could tap into this emerging market in China.

Australian companies are adept at introducing advanced technologies from developed economies to provide cost-effective solutions. They could integrate core imported equipment from developed economies with lower-priced non-core parts and components produced in China to compete in the market. Furthermore, backed by a sound legal system reputed internationally for its excellent protection of intellectual property rights, foreign investors could use Australia as a base to engage in technology transfer, and licensing can expect sound protection of their intellectual property rights.

### *Aligning business plans with development priorities of governments*

Chinese leaders have now concluded that their success in positioning China as the point of final assembly in an integrated East and Southeast Asian manufacturing system is no longer the key to future development. They are now trying to reposition the country so that it can create a capacity for indigenous innovation, pursue scientific development, develop its own technologies and industries, and bring further inland the benefits of industrialization. If the past thirty years are anything to go by, these goals are likely to be reached sooner rather than later. Australian businesses interested in pursuing opportunities in China would do well to take these goals into account.

The importance of looking for opportunities that fit with national development plans is highlighted by the recently-reported case of the Chinese government's rejection of applications from Australian universities to teach degree courses in China as it cracks down on foreign partnerships that fail to meet its prioritised areas of national development.<sup>15</sup> Business, accounting and marketing degrees were most frequently rejected because they failed to meet China's prioritised areas of national development, while programs in engineering, nursing, education, biomedicine, logistics, social work were approved.

There are also significant regional variations within the context of national development priorities. The significant variations in the investment landscape across China mean there are plenty of opportunities for a vast array of Australian businesses, for example for those that are involved in high-tech manufacturing and services and those that are involved in the traditional manufacturing businesses. For instance the coastal cities of China are very developed with an increasing emphasis on advanced manufacturing and value-added services whereas in some of the inland areas, especially in the Western region, the basic economic objectives are still to create basic industrial jobs to assist the transition from an agricultural economy and to provide basic housing, investment in infrastructure.

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<sup>15</sup> Australian Financial Review, 13 February 2012.

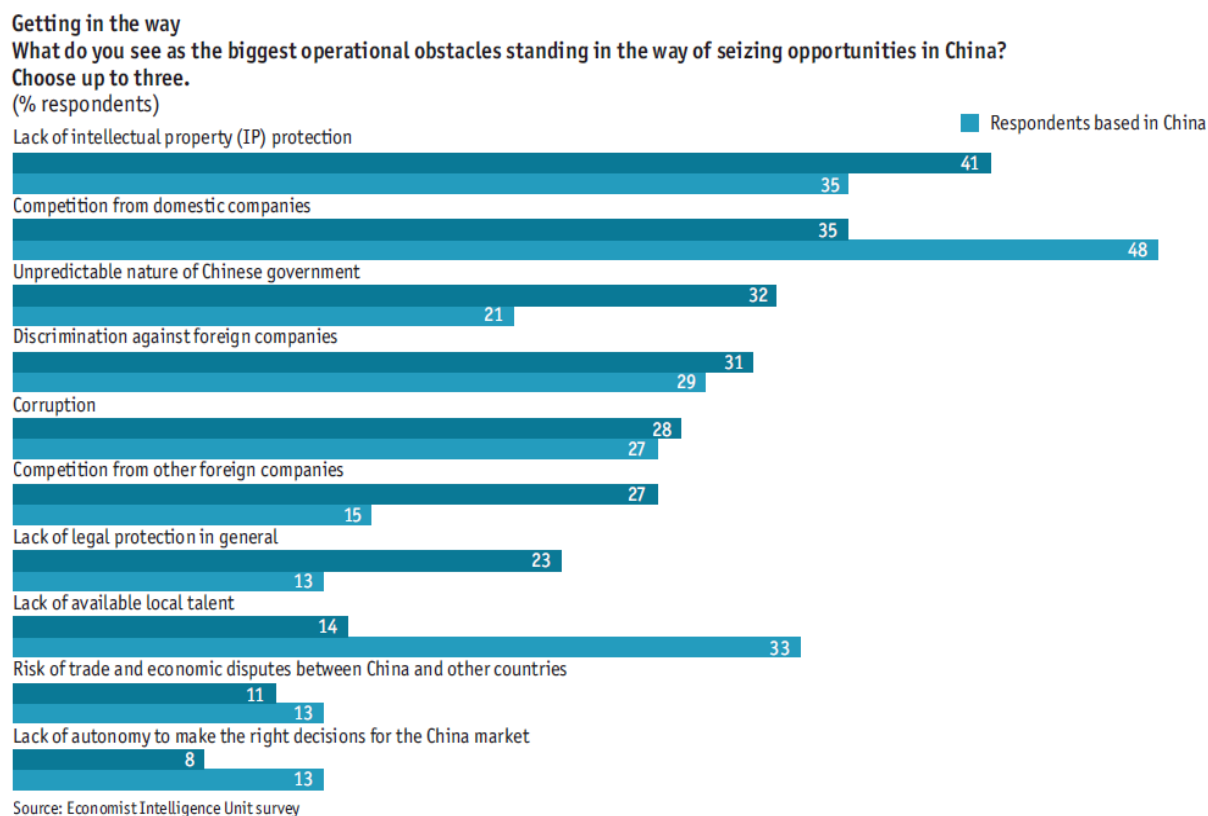


## Challenges for Australia

### Obstacles to seizing opportunities in Asia

Australian businesses still need to overcome obstacles holding them back from seizing opportunities in China. Chart 10, obtained from a survey of multinational companies conducted by the Economist Intelligence Unit (EIU), illustrates some of the challenges that multinational companies encounter as they attempt to gain market share in China.

**Chart 10: Barriers to seizing businesses opportunities in China**



Source: Economist Intelligence Unit (2011)

Respondents to the EIU survey that are based in China rank competition from local businesses at the top of their list of obstacles, while the sample as a whole ranked it second, behind intellectual-property rights protection.

China is generating local champions, many of which are state-owned enterprises (SOEs), and competing against them is challenging. Close to their customers, focused on developing lower-cost alternatives, marketing and distribution strategies, these local businesses are developing new goods and innovative ways of selling them that are well attuned to the needs of Chinese consumers.

Although the Chinese private sector expanded in size and number from the 1990s onwards, important and promising economic sectors are reserved for SOEs to compete in. While foreign-direct-investment is encouraged in these sectors, SOEs are positioned to lead these key sectors.

The sectors include banking and finance, insurance, construction, infrastructure, chemicals, media, information technology and telecommunications. In the recently announced 12<sup>th</sup> FYP, it was also announced that national champions are to take the lead in further 'strategic sectors' such as renewable energy, healthcare, biotechnology, high-end equipment manufacturing, energy-efficient vehicles and emerging information technology platforms. State capital is likely to be channelled into these industries through the formal fiscal budget and loans from state-owned banks.

It would be challenging for Australian businesses to gain market share in these emerging and lucrative sectors. The way forward may be to first understand the culture and business practices in China and then establish joint ventures with Chinese businesses.

The rising competitive strength of local Chinese businesses is also reflected in the talent market. Although EIU survey respondents as a whole ranked "lack of available local talent" quite far down the list of obstacles standing in the way of market success, a mounting array of evidence suggests they should be concerned. The respondents from China ranked the lack of talent third on their list of obstacles (respondents as a whole ranked it eighth). With many Chinese businesses flourishing and expanding at a faster pace than multinational businesses, the same pool of bilingual and bicultural local talent who can straddle the Chinese and international business worlds are being courted by both. For example, in 2010 Deutsche Bank lost its China head to Industrial and Commercial Bank of China. A few years earlier B&Q and Microsoft saw high-profile executives jump to Chinese competitors (to Alibaba and Shanda Interactive Entertainment, respectively). Ante and Li Ning, the two leading sportswear makers, also have managed to attract talent away from Nike, Adidas and Puma. This reverse flow of local talent from multinational businesses to Chinese businesses would increase in the future.

Another challenge that Australian businesses face in attempting to succeed in Asia is the large gaps in their experience and skills. For example, the survey conducted by Ai Group and Asialink in 2011 found that more than half of Australia's businesses surveyed, that currently operate in Asia, have little board and senior executive experience of Asia and/or Asian language skills.<sup>16</sup> The need for Australian businesses to be well versed in Asian culture, language, politics and business practices in order to succeed is highlighted by the Managing Director of the multi-million dollar exporter of Australian wool, Michell Group, who said that "you need to remember you are a guest in their country, so be culturally aware, understand the rules and behave accordingly".<sup>17</sup>

### *Overcoming border and behind-the-border trade and investment impediments*

Australian businesses seeking to venture into Asian markets face foreign tariff barriers and quantitative restrictions on Australian exports of primary commodities and manufactured goods. Whilst such impediments have been reduced significantly over the years through trade liberalisation, businesses still need to overcome non-tariff barriers at the border and behind-the-border restrictions that impede trade in services as well as in goods.

The nature of negotiations on behind-the-border restrictions is more complex than simply dealing with conventional tariff rates at the border. Behind-the-border impediments can take such forms as

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<sup>16</sup> Australian Industry Group and Asialink (2011)

<sup>17</sup> Austrade website

licenses, permits, complex domestic regulations and burdensome and time-consuming processing of applications. Negotiating changes in these restrictions inevitably will involve engaging not only with trade officials but with domestic regulators at both national and regional levels.

#### *New Asian manufacturing capabilities pose threats to Australian manufacturing*

The rise of more additional manufacturing capacity both in and beyond China, will pose further threats to the long-term viability of some Australian manufacturers. This problem is exacerbated by the strong dollar and the deterioration in cost competitiveness due to weak productivity growth and relatively high growth in wage rates.

#### *China's bid to fast track high-tech manufacturing could overshadow Australia's efforts*

The Chinese Government's bid to spur growth in the country's high technology manufacturing to counter the problem of rapidly rising industrial wages could increase the pressures on many Australian manufacturers. This could arise as high value-added manufacturing destined for Australia could be siphoned off to China instead, lured by the abundance of highly skilled technicians in China, the relatively low labour cost and business-friendly government policies. In the absence of greater policy focus and change in business strategies to engage with Asia, Australia's opportunities in manufacturing may not be realised.

## Implications for Policy Settings in Australia

A joint report in 2011 released by Ai Group and Asialink highlighted just how important the Asian region is to Australia's prospects, and also demonstrated that Australia needs to do much more as a country to get the most out of the export and investment opportunities in the region.

Ai Group is of the view that it is critical that Australia actively cultivates its links with the fastest growing region in the world – Asia. Australia must have an outward focus that looks beyond the domestic market and local opportunities and focus on developing an “Asia-ready” workforce that is highly capable, creative, adaptable, technically skilled and well-versed in the various cultural, bureaucratic, political, linguistic and business ways of the various individual economies in our region. Better literacy of the power balances in the region is also important. These elements are the responsibility of not only Federal and State Governments but industry as well.

The benefits derived from Asian immigration in building networks and links between Asia and Australia could also be enhanced through the introduction of a new Colombo Plan scholarship. The recipients of this scholarship may be enticed to stay on in Australia, contributing to the local communities and the Australian economy while helping to establish links with Asia.

There appears to be an under engagement of non-official resources in our interactions with Asian economies. More investment is required in people-to-people and business-to-business links and schemes. This could be developed through more support for people-to-people exchanges at all levels, as well as Australian businesses adopting mentoring partnerships with successful, respected and experienced companies with good links and reputation with governments and local businesses in Asian economies. There are also Australian based businesses that have been operating very successfully in Asian economies for a long time who could share their stories of success and the pitfalls of doing business in particular economies. Industry could be further supported by increased support through programs like the APEC Business Travel Card.

Australian industry must lift productivity and improve its competitiveness against Asian economies and expeditiously take up new and expand on current opportunities. Australian governments could should assist in lifting national productivity through continued investments to improve infrastructure, changes in policy to stimulate entrepreneurship, risk-taking, innovation and research and development, tax reforms and reductions in the regulatory burden on businesses, to enable them to compete more effectively in the Asian markets.

A continued concerted effort should also be put into removing and reducing regulatory restrictions and barriers to two-way trade and investment in the region. In addition, behind-the-border trade restrictions must be tackled through appropriate channels including the WTO.

In addition to removing trade barriers, the Australian Government could also assist by enhancing schemes designed to promote Australian exports. An example would be to enhance the Export Market Development Grant scheme by increasing Government funding for eligible export promotion expenses, as well as increase the number of times funding may be obtained by each eligible applicant. There should be closer coordination and collaboration between the Federal and State Governments in trade and investment promotional tours in Asia.

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